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Written Testimony

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Hearing before the House Judiciary Committee

Competition and Commerce in Digital Books

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Mr. Chairman and Members of the Committee:

Thank you for the invitation to testify today on competition and commerce issues in digital books. My name is Randal C. Picker. I am the Paul and Theo Leffmann Professor of Commercial Law at the University of Chicago Law School. I am also a Senior Fellow at the Computation Institute of The University of Chicago and Argonne National Laboratory. I have taught at Chicago since 1989 and write and teach in a number of areas including, of relevance to today's hearing, antitrust, copyright and network industries.

Faculty offices at the University of Chicago Law School are physically in the D'Angelo Law Library. I walk out of my office door into book stacks and I feel very lucky to have ready access to one of the world's great university libraries. Yet notwithstanding that, I have an almost unnatural level of affection for Google Book Search. If you haven't used it, you should, as it is a wonder. I have been doing research into some business practices in the early 1900s. Google Book Search is a powerful window into the past and one that I can look through from any computer anywhere. And, again, I say that as someone who has a great library literally outside his office door. Imagine what that access means for people who are less fortunate.

But creating a great new product doesn't somehow entitle a firm to a broad exemption from the law of the land. We wouldn't consider for an instant allowing Google or any other firm to violate environmental laws or civil rights laws merely because they were creating a great new product. You have to do both: innovate and comply with the law. More precisely here, the fact that Google Book Search generates substantial benefits to consumers does not somehow insulate the Google Book Search settlement from antitrust inquiry. We should expect antitrust officials to assess whether

those benefits can be preserved while at the same time minimizing any possible anti-competitive features of the settlement. Antitrust officials do not and should not allow firms to engage in anti-competitive practices merely because those practices have been bundled into a larger project that has substantial competitive benefits. Antitrust regulators need to separate the pro-competitive wheat from the anti-competitive chaff.

Earlier this year, I was asked to speak at a conference at Columbia Law school on antitrust and competition issues in the GBS settlement. In connection with preparing for that talk, I commenced a draft of the paper on those issues and subsequently completed it after the conference. That article was recently published in the September, 2009 issue of the *Journal of Competition, Law and Economics*. A preprint version of that article is attached to this testimony and my testimony is largely based on the article, though my thinking about the consequences of the GBS settlement has continued to evolve and there are some new thoughts in this testimony.

I make three central points in the article and those points are addressed to three different government audiences, first to the courts, then to the Antitrust Division in the Department of Justice, and then to the courts but really to Congress. Take those points one by one.

1. *No Antitrust Immunity from Approval of the Settlement*. One point is a particularly technical issue of antitrust law, namely whether court approval of the GBS settlement will insulate it from subsequent antitrust inquiry. This is a question of the scope of the *Noerr-Pennington* doctrine of antitrust immunity. That point is addressed to the court system and first to Judge Chin in particular who has the proposed settlement before him. Antitrust law provides that parties can petition the government and ask for competitive benefits without fear of antitrust prosecution, but the precise boundaries of that doctrine are uncertain. Should Judge Chin approve the settlement agreement, I don't believe that *Noerr-Pennington* immunity should attach, but I don't think the cases on this are completely clear. Should he approve the agreement, I think Judge Chin should add a provision stating that it is not his intent for *Noerr-Pennington* immunity to attach. I call this a no-*Noerr* clause. I should say that I made this up out of whole cloth and have no idea whether a subsequent court would respect that intent.

2. *Collective Pricing of Consumer Purchases as Sherman Act Section 1 Violation*. The second point is about the pricing mechanism for consumer purchases in Google Book Search. That point is addressed to our antitrust prosecutors. The Department of Justice is expected to file its views in this case by September 18, 2009. There are two core business models contemplated by the settlement. One is a blanket-license subscription for institutions to confer online bulk access to all of the works in Google Book Search. Although there have been concerns raised about the pricing of these blanket licenses, my paper says very little about those. Under current United States antitrust doctrine, high prices associated with legitimately obtain monopolies do not give rise to antitrust violations. We accept those prices as a consequence of successful competition. My paper instead addresses the second business of the settlement, namely sales of individual

access to online books to consumers. This is the online equivalent of going into Borders to buy a single copy of a book.

The settlement agreement implements a pricing algorithm for these individual consumer sales that is, like almost everything else in the agreement, quite complex. That said, I suggest in my article that there are ways that the algorithm can result in coordinated pricing among individual authors in a way that could give rise to problems under Section 1 of the Sherman Act which forbids much joint pricing as collusive. I don't regard that as a slam dunk argument, as I think that the pricing algorithm raises new issues, but I think that there is a good chance that the Department of Justice will address it in its filing.

3. *The Government Should Not Issue Just One License for the Use of Orphan Works.* The third point is addressed to Congress first and foremost but also to the court system. A key feature of the class-action settlement is that it will make available to Google – and only Google – the so-called orphan works. These are works that remain in copyright but where the holder of the copyright cannot be tracked down so that his or her work could be used with permission. I have seen figures from Google suggesting that perhaps as many as 80% of the works in GBS are orphans. The opt-out class action inverts the usual rule of copyright on its head. Usually someone like Google would need to get permission to use a copyrighted work unless its use would qualify as a fair use. Absent fair use, you have to ask to use a copyrighted work, and the problem with orphans is that you don't know who to ask.

The opt-out class action changes this. Orphan rightsholders need to come forward to be excluded from the settlement, and if they don't, Google will get full rights to use those works. Usually if you ask a copyright holder for permission and you don't get a response, you get nothing. You get no right to use the work at all. But here with the opt-out class action, silence is indeed golden: Google will get full rights to use the orphan works.

Google and the Authors Guild could implement large chunks of their agreement as a private deal without court approval. The key point of running this business plan through the court system is that it will give Google a government license to use the orphan works. No private party can create a right to use the orphan works. Only the government can do so either through some form of opt-out class action or if Congress enacts broader orphan-works legislation.

That leads to a number of natural questions. Under what circumstances should the government create a right to use the orphan works? Should the government create a right in favor of only one firm and thereby create a monopoly over those works or should the government grant multiple licenses to spur competition? If Google or Microsoft or Amazon came to Congress seeking orphan-works legislation, could we imagine new copyright legislation that granted a right in favor of only one of those companies and not the others? Given the role of the government in authorizing the use of the orphan works, the government will choose precisely how much competition is

possible. If only one firm is authorized to use those works, we will have a monopoly over those works.

My paper discusses ways in which the federal district court considering the settlement agreement might consider broadening that agreement to allow other firms to use the orphan works. But there is a more direct route available and that would be for Congress to pass orphan-works legislation. In considering that possibility, it is important to recognize how different the proposed settlement is from orphan-works legislation has been proposed in the past. That legislation typically has contemplated that an extensive search would be performed by the person or firm contemplating the use of the work that it believes to be an orphan. The only way to know that you have an orphan is to look for the owner.

The problem with that is that it imposes a substantial burden—indeed perhaps a crippling burden—on mass digitization efforts of the sort seen in Google Book Search. Anything that would require human beings to search individually as opposed to computers proceeding automatically would, I suspect, raise costs sufficiently to block most large-scale digitization efforts. In contrast, the Google Book Search settlement requires no such search in advance to include orphan works in the database. Moving from a required-search version of orphan-works legislation to something closer to the Google Book Search settlement might raise issues under the Berne convention, but those might be sidestepped by limiting the orphan-works legislation to United States works akin to what we do for the registration rules set out in Section 411 of the Copyright Act.

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To close, we might return to the early 1900s and the days of player pianos. It wasn't clear whether the piano rolls infringed on the underlying musical composition that they played. In 1908, in the *White-Smith* case, the Supreme Court ruled that the piano rolls weren't copies, but Congress planned to overturn that result in new legislation. Knowing that, Aeolian, the leading producer of player pianos, entered into widespread contracts to lock up access to the new player piano roll rights. Faced with the threat of a monopoly over those rights, Congress created the first compulsory license, the so-called mechanical license. Under that license, once a composer had licensed his or her work to one firm, a second firm could pay a statutory fee and making competing piano rolls.

Only the government can license use of the orphan works and the government will choose how many licenses to grant. One license means monopoly, open-licensing the possibility of meaningful competition. Congress should pass orphan-works legislation. To its great credit, Google remains in favor of such legislation. That legislation should track many of the features of the Google Book Search settlement so as to enable full competition in the use of orphan works. Only the government can make that competition possible.

## THE GOOGLE BOOK SEARCH SETTLEMENT: A NEW ORPHAN-WORKS MONOPOLY?

*Randal C. Picker\**

### ABSTRACT

This paper considers the proposed settlement agreement between Google and the Authors Guild relating to Google Book Search (“GBS”). I focus on three issues that raise antitrust and competition policy concerns. First, the agreement calls for Google to act as agent for rights holders in setting the price of online access to consumers. Google is tasked with developing a pricing algorithm that will maximize revenues for each of those works. Direct competition among rights holders would push prices towards some measure of costs and would not be designed to maximize revenues. The consumer access pricing provision might very well fail a challenge under Section 1 of the Sherman Act. Second, and much more centrally to the settlement agreement, the opt-out class action will make it possible for Google to include orphan works in its book search service. Orphan works are works as to which the rightsholder cannot be identified or found. The opt-out class action is the vehicle for large-scale collective action by active rights holders. Active rights holders have little incentive to compete with themselves by granting multiple licenses of their works or of the orphan works. Plus under the terms of the settlement agreement, active rights holders benefit directly from the revenues attributable to orphan works used in GBS. We can mitigate the market power that will otherwise arise through the settlement by expanding the number of rights licenses available under the settlement agreement. To do that, we should take the step of unbundling the orphan works deal from the overall settlement agreement and create a separate license to use those works. All of that will undoubtedly add more complexity to what is already a large piece of work, and it may make sense to push out the new licenses to the future. That would mean ensuring now that the court retains jurisdiction to do that and/or giving the new registry created in the settlement the power to do this sort of licensing. Third, there is a risk that approval by the court of the settlement could cause antitrust immunities to

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\* Copyright © 2009, Randal C. Picker. All Rights Reserved. Paul and Theo Leffmann Professor of Commercial Law, The University of Chicago Law School and Senior Fellow, The Computation Institute of the University of Chicago and Argonne National Laboratory. This paper is based on a talk that I gave on March 13, 2009 at the conference “The Google Books Settlement: What Will It Mean for the Long Term” at Columbia Law School’s Kernochan Center for Law, Media and the Arts. I thank the Kernochan Center for hosting the conference and June Besek in particular for inviting me. I thank the John M. Olin Foundation and the Paul H. Leffmann Fund for their generous research support. I also thank Matthew Stoker for research assistance. Three disclaimers. First, I have served as a consultant in connection with the opposition to Google’s proposed deals with DoubleClick and Yahoo!. I think that nothing there bears directly on the issues raised in this paper. Second, I have received research grants from Microsoft directly and the Law School receives funding from Microsoft. Again, I think that none of these bear directly on this paper. Third, and finally, I currently chair the faculty board for the Library at the University of Chicago. Our library is a member of the Committee on Institutional Cooperation, a library consortium of Chicago and the eleven schools in the Big Ten. As a group, the CIC has been library partners with Google since June, 2007.

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attach to the arrangements created by the settlement agreement. As it is highly unlikely that the fairness hearing will undertake a meaningful antitrust analysis of those arrangements, if the district court approves the settlement, the court should include a clause—call this a no *Noerr* clause—in the order approving the settlement providing that no antitrust immunities attach from the court’s approval.

*JEL*: D4; K20; K21; K41; L4; L43; O34

## I. INTRODUCTION

Google is a company of modest ambitions. As it says in its brief corporate statement, Google’s mission is to “organize the world’s information and make it universally accessible and useful.”<sup>1</sup> Organize it, put it online, display it and make a few dollars at the same time. Google’s Book Search is a core piece of this vision. Think of the world’s great libraries, all merged into one collection and all available online through any device connected to the Internet. Universal access indeed.

But creating such a wonder is not a simple undertaking. Books have to be found, bought or borrowed and copied. The resulting digital files need to be sliced and diced to make them as useful as possible but also preserved so that looking at books online is very much like looking at them offline. This is a substantial technical undertaking, plus we need to figure out a business model for accessing the books. In the past—and still today of course—individuals purchased books or borrowed them from libraries, who in turn had purchased the books. Will digital copies be purchased in the same fashion or will different rules apply? Were these technical and economic challenges not enough, we would confront the really hard problem, namely, how do we match an 18<sup>th</sup> century legal system with early 21<sup>st</sup> century opportunities?

Google moved forward nonetheless. That in turn led to two lawsuits and an eventual settlement agreement that will be considered at a fairness hearing in federal district court on October 7, 2009. The settlement agreement is exceedingly complex—though not obviously unnecessarily so—as befits an agreement that will create an extraordinary new platform for accessing books.<sup>2</sup> Successful new book platforms are rare—since Gutenberg have there been any?—and Google’s is of breathtaking ambition.

This paper considers some of the antitrust and competition policy issues raised by the settlement agreement. The paper itself is divided into seven sections. Section II provides brief background to the creation of Google Book

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<sup>1</sup> See Google Corporate Information, <http://www.google.com/corporate/> (last visited July 8, 2009).

<sup>2</sup> See The Official Settlement Agreement, <http://www.googlebooksettlement.com/> (last visited July 8, 2009). See also Google’s Discussion of the Settlement, <http://books.google.com/googlebooks/agreement/> (last visited July 5, 2009).

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Search and the lawsuits that emerged. Section III sets out five quick situations—hypotheticals, as we call them in law school—to try to establish some antitrust bearings to help us triangulate on the settlement agreement.

Section IV sets out some of the salient features of the settlement agreement. Absent the lawsuit by the Authors Guild, the settlement agreement would be nothing more than a private contract between Google and individual rightsholders with both horizontal and vertical components. The lawsuit does not change that essentially though it does have the key consequence of bringing so-called orphan works within the agreement. These are works that remain within copyright but that are stuck in limbo: the rightsholder for the book cannot be identified or, if identifiable, cannot be tracked down. That means that it is not possible to license access to the work. You cannot contract with people you cannot identify or find.

That takes us to two antitrust/competition policy issues and then to a key question of timing and comparative institutional advantage. First, the settlement agreement implements a pricing algorithm for single-copy access to digital books that I think is questionable. This is a joint agreement among rightsholders with Google as to how Google will price online access to their works going forward. Rightsholders can choose to appoint Google as their agent for pricing online access to consumers where Google will seek to maximize revenues for each book. That is not the result that would emerge under pure competition between authors/rightsholders and seems likely to run afoul of Section 1 of the Sherman Act.

Second, as currently configured, the settlement agreement creates unique access for Google to orphan works. This emerges directly from the court's presence. Absent the lawsuit by the Authors Guild, Google and interested rightsholders could have crafted a deal very much like that in the settlement agreement and would have implemented that through private contracts. That deal, of course, would be subject to antitrust scrutiny, as it would involve large numbers of otherwise competing rightsholders contracting together with Google. That would not be unprecedented—we have similarly complex arrangements for other copyright collectives like ASCAP and BMI—but definitely worth antitrust attention (70 years worth for our music cooperatives).

But with the lawsuit and the opt-out class action, we have left the world of purely-private contracts. For some rightsholders, that change is just a bother: they would not have had to sign a private deal and could have done nothing but now must affirmatively opt out of the settlement. But for our orphan rightsholders, the change in default positions is everything. The orphan holders cannot act and the settlement agreement neatly sweeps them up to give Google releases for the ongoing use of their works. The settlement agreement solves this problem for Google, but only for Google, in creating a carefully-crafted license for Google to use those works. The great accomplishment of the settlement is

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precisely in the way that it uses the opt-out class action to sidestep the orphan works problem. But, as has been noted elsewhere,<sup>3</sup> this gives Google an initial monopoly—and possibly a long-running one—over the use of the orphan works. This emerges *directly* from the court's role in this case because, again, the settlement agreement between Google and active rightsholders could have been implemented as a private matter without a lawsuit, though, again, with perhaps substantial antitrust attention. But the lawsuit is the device by which the initial orphan works monopoly is created: without the lawsuit, Google would acquire *no* rights to use the orphan works.

The way to prevent the creation of the market power that will arise directly from the court's role in approving the settlement would be to modify the settlement agreement by expanding the licenses created under it. I consider this issue in Section V. I think that there are strong reasons to think that the license created by the settlement agreement should be expanded so as to mitigate the market power that the court's approval of the settlement agreement will otherwise create. The most natural hook for this substantively would be the agreement's most-favored nations clause, which currently runs only in favor of Google. A more symmetric MFN would create a going-forward licensing mechanism for other entities to license the works of the active rightsholders as well to use the orphan works.

But I do think that there is a timing issue on that. Without real parties before the court on this, we are just shadowboxing. I do not know that I would modify the MFN clause in the abstract; we should probably wait instead until we have an actual case before us. The settlement agreement provides that the court will retain jurisdiction over it going forward. That jurisdiction needs to include the possibility that other parties can subsequently come to court and seek licenses. Another possibility is to ensure that the registry created under the settlement agreement has the power to issue licenses going forward. And there is a plausible reading of the settlement agreement that suggests that the registry is intended to have the authority to license the orphan works to third parties.

There is a second timing question and I consider that in Section VI. A standard fairness hearing for a class-action settlement does not begin to look anything like an antitrust inquiry. There will be no effort to define markets or any effort to inquire systematically into the likely market effects of a settlement. Fairness hearings often will just focus on what the proposed settlement means for the direct parties to the litigation, but even courts that consider more factors,

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<sup>3</sup> See James Gibson, *Google's New Monopoly*, Wash. Post, Nov. 3, 2008, at A21; see James Grimmelmann, *How to Improve the Google Book Search Settlement*, 12 J. Internet L. at 1, 11-20 (April 2009), *available at* [http://works.bepress.com/cgi/viewcontent.cgi?article=1022&context=james\\_grimmelmann](http://works.bepress.com/cgi/viewcontent.cgi?article=1022&context=james_grimmelmann); see Robert Darnton, *Google & the Future of Books*, 56 N.Y. Rev. Books 2 (Feb. 12, 2009), *available at* <http://www.nybooks.com/articles/22281>.

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including a public interest factor, are unlikely to conduct a searching antitrust inquiry. The fairness hearing will also not come close to matching the business review process undertaken by the Antitrust Division of the Department of Justice when parties want some level of pre-deal comfort on their planned business arrangements.<sup>4</sup> All of this suggests that the approval of the settlement agreement by the court should not cause some sort of antitrust immunity to attach to the agreement. Under the current caselaw, there is some risk of that and Google and the Authors Guild will clearly argue for such immunities after the fact. The district court considering the agreement might minimize that risk by expressly providing in an order approving the settlement agreement that no antitrust immunities will attach from the court's approval of the agreement—a no *Noerr* clause as it were.<sup>5</sup>

## II. BRIEF BACKGROUND TO THE SETTLEMENT

Books are the quintessential copyrighted works. The 1790 Copyright Act—the U.S.'s first federal copyright statute—addressed “any map, chart, book or books.”<sup>6</sup> And copying a book—in its entirety—is exactly the sort of act that we would think would run afoul of most copyright laws. Of course, a project such as the one envisioned by Google—the world's information online—would necessarily intersect with copyright laws across the planet and across time. To simplify considerably, such a project would necessarily confront three key situations. The first would relate to works in the public domain, that great repository of expression available to be drawn upon by anyone at any time. The second would relate to works of authors or publishers—whomever holds the copyright—who could easily be found. For those works, we might imagine that consent of some sort would be the appropriate vehicle for determining whether works were or were not in our online collection. The need for consent would of course be tempered by the doctrine of fair use which makes possible use of copyrighted works without the copyright holder's permission in circumstances which are, to say the least, unclear.<sup>7</sup> Third, an online database of books would need to figure out what to do about orphan works. These are works that remain within copyright—they have not entered the public domain—but books as to which the copyright holder simply cannot be tracked down. These are not works

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<sup>4</sup> 28 C.F.R. § 50.6 (2009). *See also* Antitrust Division, U.S. Department of Justice, Instructions for Business Reviews, <http://www.usdoj.gov/atr/public/busreview/201659b.htm> (last visited July 5, 2009).

<sup>5</sup> *See* Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc., 508 U.S. 49 (1993); Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961); United Mine Workers v. Pennington, 381 U.S. 657 (1985).

<sup>6</sup> 1 Stat. 124 (1790).

<sup>7</sup> *See* 17 U.S.C. § 107 (2009).

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that we can all draw upon—they are not in the public domain—nor works for which consent provides a simple sorting mechanism.

Notwithstanding all of this, Google pressed forward.<sup>8</sup> After doing preliminary work in 2002 and 2003, on October 7, 2004, Google announced its new Google Print Service at the Frankfurt Book Fair.<sup>9</sup> More than a dozen publishers had agreed to participate in the new service which would bring their books into the Google search engine. Google would provide limited online access to chunks of the books—snippets—while linking to places to buy the books. Two months later, Google announced that it was working with the libraries of Harvard, Stanford, the University of Michigan and the University of Oxford and the New York public library to scan their collections and to bring them online.<sup>10</sup> Michigan made clear that the ambition of the project was to add all of the 7 million volumes in the Michigan library to the Google search engine and to, in the words of University of Michigan president Mary Sue Coleman, launch an era “when the printed record of civilization is accessible to every person in the world with Internet access.”<sup>11</sup>

On September 20, 2005, the Authors Guild brought a class action suit against Google alleging copyright infringement relating to the copying of books from the Michigan library.<sup>12</sup> A month later, five publishing companies brought a similar action against Google.<sup>13</sup> Fast forward three years. On October 28, 2008, the Authors Guild, the Association of American Publishers and Google announced a settlement to the pending lawsuits.<sup>14</sup> That settlement agreement, now pending in federal district court in New York, will create a comprehensive

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<sup>8</sup> See History of Google Book Search, <http://books.google.com/googlebooks/history.html> (last visited July 5, 2009).

<sup>9</sup> See Edward Wyatt, *New Google Service May Strain Old Ties in Bookselling*, N.Y. Times, Oct. 8, 2004, available at <http://www.nytimes.com/2004/10/08/technology/08book.html>.

<sup>10</sup> See Press Release, Google Inc., Google Checks Out Library Books (Dec. 14, 2004), [http://www.google.com/press/pressrel/print\\_library.html](http://www.google.com/press/pressrel/print_library.html).

<sup>11</sup> See Press Release, University of Michigan News Service, Google/U-M Project Opens the Way to Universal Access to Information (Dec. 14, 2004), <http://www.umich.edu/news/?Releases/2004/Dec04/library/index>.

<sup>12</sup> See Class Action Complaint, *The Author's Guild v. Google Inc.*, 05 CV 8136 (S.D.N.Y. 2005), available at <http://www.authorsguild.org/advocacy/articles/settlement-resources.attachment/authors-guild-v-google/Authors%20Guild%20v%20Google%2009202005.pdf>.

<sup>13</sup> See Complaint, *McGraw-Hill Co., Inc. v. Google Inc.*, 05 CV 8881 (S.D.N.Y. 2005), available at <http://www.authorsguild.org/advocacy/articles/settlement-resources.attachment/mcgraw-hill/McGraw-Hill%20v.%20Google%2010192005.pdf>.

<sup>14</sup> See Press Release, *The Authors Guild, Authors, Publishers and Google Reach Landmark Settlement* (Oct. 28, 2008), [http://www.authorsguild.org/advocacy/articles/settlement-resources.attachment/press\\_release\\_final\\_102808/press\\_release\\_final\\_102808.pdf](http://www.authorsguild.org/advocacy/articles/settlement-resources.attachment/press_release_final_102808/press_release_final_102808.pdf).

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new regime for online access to United States books. A fairness hearing will be held on the proposed settlement on October 7, 2009 and, before that date, class members who wish to opt out must do so by September 4, 2009.<sup>15</sup>

### III. FIVE HYPOTHETICALS

It might be useful to frame the GBS settlement by considering five hypothetical cases.

1. *Poodle Book Quote*. An entrepreneur—call the company Poodle—buys a physical copy of every book ever written. Customers call a toll-free number to ask about book quotes. In response to an inquiry, human beings scurry around a vast warehouse of books looking for quotes. Poodle initially charges a modest fee for the service but it is a hit with consumers and, facing no competition, Poodle jacks up its prices, enjoying the benefits of monopoly power.

What do copyright and antitrust say about this? Nothing, I think. Poodle has purchased books, not made copies of them, and the use that Poodle is making of the books almost certainly falls within traditional notions of fair use. As to antitrust, Poodle has acted on its own and has created a great product with a corresponding market power through successful competition in the marketplace. Antitrust does not condemn this.<sup>16</sup> Indeed, as the Supreme Court put it in its most recent antitrust decision “[s]imply possessing monopoly power and charging monopoly prices does not violate §2 ... .”<sup>17</sup> Tweak this case slightly. Switch from purchased physical copies to digitized copies and have the quotes returned by a computing system algorithmically rather than by human beings. Given the massive copying through digitization, the copyright issues are quite different, but I see no change in the antitrust analysis of the situation.

2. *Digital Book Rights*. An author writes a book, publishes it on paper and retains the copyright. An entrepreneur approaches our author and seeks a license to sell digital copies of the book. Where do we stand? Our author starts with the full set of rights assigned to her by the Copyright Act. Those are statutorily defined rights—start with Section 106—and those rights are limited in some cases by compulsory statutory licenses and by the uncertain but overriding rules of fair use. But none of those rights limit her ability to license whatever rights

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<sup>15</sup> See Authors Guild v. Google Settlement Resources Page, <http://www.authorsguild.org/advocacy/articles/settlement-resources.html> (last visited July 5, 2009).

<sup>16</sup> As Judge Learned Hand famously put it in *United States v. Aluminum Co. of America*, 148 F.2d 416, 430 (1945): “A single producer may be the survivor out of a group of active competitors, merely by virtue of his superior skill, foresight and industry. In such cases a strong argument can be made that, although the result may expose the public to the evils of monopoly, the Act does not mean to condemn the resultant of those very forces which it is its prime object to foster: *finis opus coronat*. The successful competitor, having been urged to compete, must not be turned upon when he wins.”

<sup>17</sup> *Pacific Bell Telephone Co. v. Linkline Communications, Inc.*, 555 U.S. \_\_\_\_ (2009).

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she has to a third party; indeed, the Copyright Act contemplates such transactions and sets out basic rules governing them.<sup>18</sup> This transaction poses no copyright issues and we should think as such also poses no antitrust issues. Neither copyright nor antitrust insists that an author on her own exploit all of the uses of her work. Put differently, she need not vertically integrate into all fields where her work might be used. If she prefers to license the right to someone else to exploit her work in a particular medium, she is fully entitled to do so under copyright law and nothing in antitrust should foreclose this. Moreover, copyright law does not create an obligation for her to license her work to a second person merely because she licensed it to a first person. If JK Rowling chooses to allow a movie to be made of her latest Harry Potter novel, she does not need to license all comers who might like a chance to make competing versions of that movie.

3. *Digital Books Cartel*. One hundred authors—all of the authors in our little universe—write novels, publish them on paper and retain copyright to their individual works. They compete vigorously in the offline space with each author setting the price for his work. But as they approach a new medium—digital copies of works—they get together to implement a centralized sale system. In that medium, they set a uniform price for each work of \$9.99. What does copyright law or antitrust law say about the situation? Again, copyright law proper says very little about this. Each author would be entitled to exploit her copyright in the new medium. We do see occasional nods towards the doctrine of copyright misuse, which clearly embraces some notion of competitive harm as a within-copyright limitation, but the application of that is typically quite uncertain.<sup>19</sup> But antitrust law is ready to address this situation, as this is classic price-fixing in violation of section 1 of the Sherman Act. Price-fixing remains one of the few behaviors that is *per se* illegal under Section 1.<sup>20</sup> That means that no further inquiry is required into market structure or actual market harm.

4. *Author Book Quote*. Return to the first case, but change the facts. Instead of Poodle buying physical books, the authors/rightsholders get together as a group, digitize copies of their books, and put these online as a searchable quote service. Access to individual books is sufficiently limited that we would not think of the online access as a substitute for purchasing a physical copy of the book. The service is a quote service, with charges per quote or with some sort of unlimited use blanket-license fee.

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<sup>18</sup> See 17 U.S.C. § 201-04 (2009).

<sup>19</sup> See, e.g., *Practice Management Information Corp. v. American Medical Ass'n*, 121 F.3d 516 (9<sup>th</sup> Cir. 1997), *amended by* 133 F.3d 1140 (9<sup>th</sup> Cir. 1998).

<sup>20</sup> *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 133 (1998) (citing cases).

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Again, there should be no copyright issues here assuming that the authors control their own copyrights. As to antitrust, we are now edging close to something like ASCAP or BMI, where we are nearing seventy years of antitrust regulation of those copyright collectives. Now alter this case slightly and consider a few key questions. They authors conclude that they do not want to enter the book quote business as they do not believe that search is their comparative advantage. But they do form a joint digital rights licensing group with the thought that they will then license those digital rights to firms that want to enter the book quote market. How many licenses would such a monopoly seller want to grant? One to, in my hypo, Poodle? More than one? A license to any entrant in the book quote business? How do we think that book-right licensing would work if the authors could not proceed collectively but instead were required to act individually? Would that alter the number of book quote entrants who would be able to obtain access to some digital rights?

5. *Monopoly by Statute.* Poodle approaches Congress and asks it to enact the “Online Book Quote Monopoly Act of 2009.” Under the bill, Poodle would be the only company permitted to offer an online book quote service. Congress passes the act. This would almost certainly be bad policy, but that is not the same thing as an antitrust violation. We have been reluctant to create antitrust roadblocks to efforts to petition the government. Firms can pursue anti-competitive ends through the legal process. We could try to control those efforts through antitrust or we can give free flow to these forces consistent with fundamental First Amendment values. The *Noerr-Pennington* doctrine creates a broad antitrust immunity that protects efforts to seek competitive benefits from the government.<sup>21</sup>

#### IV. THE GBS SETTLEMENT

These five cases provide natural starting points for analyzing the settlement agreement currently under consideration in the class-action suit by the Authors Guild against Google for Google’s book search service. The actual service provided is substantially more complicated than my examples and the settlement agreement infinitely more complex but we need starting points and these five examples should do the trick.<sup>22</sup>

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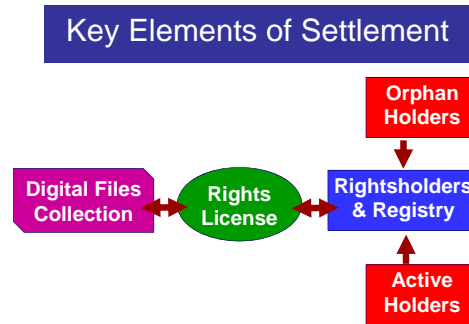
<sup>21</sup> See *supra* note 5.

<sup>22</sup> And the settlement agreement itself is not the only relevant document to the rights that will emerge from this process. For example, subsequent to completing the settlement agreement, Google signed a revised digitization agreement with the University of Michigan. See Press Release, University of Michigan News Service, U-M first to sign new digitization agreement with Google (May 20, 2009), <http://www.ns.umich.edu/htdocs/releases/story.php?id=7162>.

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### A. Key Structural Components

We should start by identifying key structural components of the settlement:



Google has set out to create a collection of digital files. It has done this through scanning books from a variety of sources but the two key sources are those that come from the Google Partner Program and the Google Library Project.<sup>23</sup> This allows Google to create Google Book Search which encapsulates the full variety of uses of the books that it has digitized.<sup>24</sup>

Without licenses from rightholders, it is not clear what Google could do with its digital collection. Google might have litigated a fair use claim to limit its exposure for copyright infringement, but it has instead chosen to seek licenses to use its amassed digital files. The settlement agreement itself operates as a rights license. That license sits between Google, as owner of its digital files collection, and the rightholders and the registry created by the settlement to act on behalf of the rightholders. As to the rightholders, we can usefully divide them into active holders and orphan (inactive) holders.

We might think of the settlement agreement as two related deals neatly fused together. The class action itself is an opt-out class action and therefore any rightholder who chooses to opt out neither enjoys the benefits of the settlement agreement nor is subject to its terms.<sup>25</sup> Of course, opt out is an active step and the class-action mechanism allows Google to sidestep neatly the problem of orphan works, as the holders of those works presumably will not opt out of the settlement. An orphan holder who shows up and opts out of the settlement is no longer an orphan, as we can now match the right in question with a particular individual or firm.

<sup>23</sup> See Settlement Agreement at §§ 1.62, -61, The Authors Guild, Inc., Association of American Publishers, Inc., et al. v. Google Inc., No. 05 CV 8136 (S.D.N.Y. Oct. 28, 2008), available at <http://www.authorsguild.org/advocacy/articles/settlement-resources.attachment/settlement/Settlement%20Agreement.pdf> ("Settlement Agreement").

<sup>24</sup> *Id.* §§ 1.60, 2.1(a).

<sup>25</sup> *Id.* § 17.33.

Active rights holders can embrace the settlement as is or opt out in toto. But opt out is only one way in which the collection can be limited. The agreement contemplates a removal mechanism to remove individual works from Google’s collection.<sup>26</sup> The right to remove is time-limited and expires at the end of 27 months after the notice commencement date.<sup>27</sup> There is also a partial removal mechanism, which allows rightholders to exclude a work from particular display uses or revenue models.<sup>28</sup> These mechanisms are substantially more complicated than this quick summary suggests, as the agreement makes an effort to ensure that books made available generally to consumers are also included in institutional subscriptions—the so-called “coupling requirement”—but I will avoid most of these details here.<sup>29</sup>

The definition of “Book” is fundamental both for what it tells us about the works covered by the settlement and for what it says about how Google Book Search will evolve after the settlement is in place.<sup>30</sup> The definition covers written or printed United States works (as defined in the Copyright Act)<sup>31</sup> that have been registered with the U.S. Copyright Office and published before the Notice Commencement Date, which is January 5, 2009, the date of the first notice of the class action settlement.<sup>32</sup> The definition then excludes, among other things, periodicals, music books, works in the public domain and governmental works.

This raises two key points. The settlement is first backwards looking. That is exactly what we would expect for past damages, if any of course, but the settlement also will put in place licenses for the use of these works going forward but only for books that are registered U.S. books before January 5, 2009. That sounds like Google Book Search is not really a library of all books ever written but just those published in the United States before early-2009. A great resource to be sure, but one frozen at a point in time. That takes us naturally to the second point: Google will add content to GBS through separately negotiated contracts. That shows up most directly in the settlement agreement in the Google Partner Program, which contemplates exactly these sort of contracts.<sup>33</sup> To put the point slightly differently, Google must contract going forward to

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<sup>26</sup> *Id.* §§ 1.124, 3.5(a).

<sup>27</sup> *Id.* § 3.5(a)(iii).

<sup>28</sup> *See* Settlement Agreement, *supra* note 23, at 3.5(b).

<sup>29</sup> *Id.* § 3.5(b)(iii).

<sup>30</sup> *Id.* § 1.16.

<sup>31</sup> *See* 17 U.S.C. § 101 (2009).

<sup>32</sup> *See* Settlement Agreement, *supra* note 23, at § 1.94.

<sup>33</sup> *Id.* § 1.62.

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continue to add to its collection and active rightsholders can opt out of the settlement entirely and instead pursue separate contracts with Google. The group that cannot do that of course are the inactive rightsholders—the holders of rights to the orphan works—and a settlement cut off in early-2009 will encompass all of the preexisting orphan works.

These are the two deals fused together. Active rightsholders can effectively embrace simultaneous contracts with Google pursuant to the terms of the settlement or can opt out and seek to execute separate deals with Google. Orphan rightsholders will not do anything and the settlement agreement will make it possible for Google, and really only Google, to put those works to use.

That leaves our third building block, the Registry.<sup>34</sup> We have the digital files and the licensing regime that the agreement creates for those files, but the agreement also create a new institution—the Registry—to manage many of the aspects of the settlement agreement. The Registry will act as a middleman between the rightsholders and Google. That is both about channeling money but also about managing the information that will be necessary to make this new complicated apparatus work.<sup>35</sup>

### **B. Use of Digital Copies**

We should pay some attention to who gets a digital copy of a book and how it can be used. Google will make a digital copy of a book available to the rightsholder (typically, the author or the publisher).<sup>36</sup> Google will also create a digitized works collection known as the Research Corpus and two or three sites will host it.<sup>37</sup> Libraries that have been the source of the works that make their way into Google's collection will have the chance to receive back a digital copy (the Library Digital Copy).<sup>38</sup> The agreement is a little more complex than that. Cooperating Libraries make books available to Google but do not take back digital copies.<sup>39</sup> In contrast, Fully Participating Libraries receive back digital copies—subject to extensive and complex restrictions—and can make a specified set of uses of those files.<sup>40</sup> The breadth or narrowness of those uses depends on where you sit obviously, but it seems hard to think that these uses, taken individually or together, will amount to meaningful competition to GBS itself.

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<sup>34</sup> *Id.* § 1.123, Art. VI.

<sup>35</sup> *Id.* §§ 6.1(d), 6.3, 6.5, 6.6.

<sup>36</sup> *Id.* § 3.11.

<sup>37</sup> *See* Settlement Agreement, *supra* note 23, at §§ 1.130, 7.2(d).

<sup>38</sup> *Id.* § 1.78.

<sup>39</sup> *Id.* § 1.36.

<sup>40</sup> *Id.* §§ 1.58, 7.2(a), 7.2(b), 7.2(c).

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It is clear that Google thinks of these digital files as such as belonging to Google, as the agreement limits the rights of rightsholders and the Registry to authorize the use of digital copies made by Google.<sup>41</sup> Google is authorized to make Display Uses and Non-Display Uses of the works that make it into GBS.<sup>42</sup> Display Uses turn on the business models embraced in the settlement agreement.<sup>43</sup> Non-Display Uses are at least as interesting, indeed perhaps even more so.<sup>44</sup> Google will be able to draw upon the digitized works to do internal research to improve its core search algorithms—the crown jewel of Google’s business—and to develop new services, such as much-improved automatic translation services.

Google’s competitors will not fare as well. They might turn to the Research Corpus but the agreement puts substantial limits on the sort of research that can be done. The Research Corpus brings together two overlapping sets of claims, namely, those of Google to the digital files as files it has created through its scanning efforts and then those of the rightsholders to the copyrighted works embedded in the digital files. The Research Corpus is to form the basis for what the agreement calls “Non-Consumptive Research.”<sup>45</sup> That is research that is “not research in which a researcher reads or displays substantial portions of a Book to understand the intellectual content presented within the Book.” Not reading the book to understand it but instead the use of the book for non-content understanding research. The definition sets forth five examples of research that might qualify, including research on automatic translation; indexing and search; linguistic analysis and others. This is exactly the sort of research that we should anticipate that Google will perform internally on GBS as part of its right to engage in Non-Display Uses.

The agreement limits the extent to which third parties can do this research. For-profit commercial “use of information extracted from Books” is barred, unless Google and the Registry consent to it.<sup>46</sup> That would seem to prevent the extraction of say, baseball statistics, to provide a fantasy baseball service. Moreover, the agreement expressly limits the use of “data extracted from specific Books” “to provide services to the public or a third party that compete with

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<sup>41</sup> *Id.* §§ 3.12, 6.6(b).

<sup>42</sup> *See* Settlement Agreement, *supra* note 23, at § 2.2.

<sup>43</sup> *Id.* § 1.48.

<sup>44</sup> *Id.* § 1.91; *see* Fred von Lohmann, *Google Book Search Settlement: A Reader's Guide* (2008), <http://www.eff.org/deeplinks/2008/10/google-books-settlement-readers-guide>.

<sup>45</sup> *See* Settlement Agreement, *supra* note 23, at § 1.90.

<sup>46</sup> *Id.* § 7.2(d)(viii).

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services offered by the Rightsholders of those books or by Google.”<sup>47</sup> That said, commercial exploitation of algorithms developed in doing research on the Research Corpus is permitted.<sup>48</sup> There may be some very fine lines being drawn here. Does algorithmic improvement count as information extracted from books? If so, Google would seem to have the power to block its competitors; if not, the settlement agreement seems to permit this sort of improvement, assuming of course that a prospective researcher can become a “Qualified User.”<sup>49</sup> The use of the Research Corpus is limited, in the main, to such users.<sup>50</sup> Google competitors will not easily qualify—researchers based at U.S. colleges and universities, non-profits and the government are covered directly—and both the Registry and Google must consent for a for-profit entity to so qualify.

It is not unusual for a firm to condition access to its property in a way that limits subsequent competition. For example, federal patent law makes it possible for a patent holder to limit the assignability of a license that it grants to another person. Absent the limit on assignment, the recipient of a license could immediately compete with the patent holder in the power to deliver a license to a third party. The patent holder would just create a new license for the third party but the original licensee could deliver its license to the third party if licenses were freely assignable. Federal patent law makes it possible for the original patent holder to bar assignment and avoid that competition.<sup>51</sup> To take a second example, courts sometimes enforce limits on reverse engineering of software. The limit on reverse engineering is again intended to limit the ability of the recipient of a work to compete with the originator of that work.<sup>52</sup>

All of that suggests that the limitations imposed by Google on the use of the digital files it has created are broadly consistent with the types of downstream limits on subsequent uses that we see in other circumstances. As to the rightsholders, the only wrinkle is that they are proceeding collectively in limiting that downstream competition. Were the rightsholders to proceed individually rather than collectively, we might very well see more competition as to the uses as to which the works could be put.

Again, this matters most for the orphan works. The settlement agreement is non-exclusive so a downstream user wishing to use a copyrighted work could

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<sup>47</sup> *Id.* § 7.2(d)(ix).

<sup>48</sup> *Id.* § 7.2(d)(x).

<sup>49</sup> *Id.* § 1.121.

<sup>50</sup> See Settlement Agreement, *supra* note 23, at § 7.2(d)(iii).

<sup>51</sup> *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673, 679 (9<sup>th</sup> Cir. 1996).

<sup>52</sup> *Bowers v. Baystate Technologies, Inc.*, 320 F.3d 1317, 1324-26 (Fed. Cir. 2003).

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contract directly with an active rightsholder.<sup>53</sup> The fact that the settlement agreement pushes towards a default position in which the rightsholders will have moved simultaneously in limiting downstream competition may make it easier to limit that subsequent contracting. And of course subsequent contracting is not possible as to the orphan works. But even if we do see direct contracts with active rightsholders, those holders presumably cannot contract as to the digital files that Google has created. The rightsholder can contract as to the copyrighted work, but the digital file itself is a separate matter.<sup>54</sup>

### C. Business Models

The settlement agreement contemplates a number of different business models and also contemplates that those business models may change over time. To simplify considerably, focus on institutional subscriptions and consumer purchases. Institutional subscriptions are akin to the blanket licenses that we have seen in ASCAP and BMI. A standard institutional subscription will give access to the entire body of digitized works, but for any particular work in that group, access will be limited. The agreement contemplates a high-transaction cost approach to limiting uses, meaning that it will circumscribe the ability to copy, paste and print. You can get small chunks of the works easily but they will try to make it difficult to aggregate those chunks into something that would compete directly with the traditional offline physical book.<sup>55</sup>

Institutional subscriptions will be priced usually on FTEs—full-time equivalency—meaning, in the case of academic institutions, the number of full-time equivalent students.<sup>56</sup> At what price exactly? The settlement offers pricing objectives that will result simultaneously in the realization of market rates for the books in the collection and in broad access to those books.<sup>57</sup> That may require squaring the circle, but it is clear that many fear that Google will ultimately charge monopoly prices for these institutional subscriptions.<sup>58</sup>

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<sup>53</sup> See Settlement Agreement, *supra* note 23, at § 2.4.

<sup>54</sup> It is not clear to me whether the settlement agreement makes a Host Site an owner of the Research Corpus. There is a mechanism for removing works from the Research Corpus, *id.* § 7.2(d)(iv), but that could just mean that the Host Site holds title, but a defeasable one, to the copy in the question. What turns on this could be the application of the first-sale doctrine, 17 U.S.C. § 109(a) (2009), though that doctrine seems to contemplate sale or other dispossession of the copy in question and would not seem to free the Host Site from the licensing limits of the settlement agreement.

<sup>55</sup> See Settlement Agreement, *supra* note 23, at § 4.1(d).

<sup>56</sup> *Id.* § 4.1(a)(iii).

<sup>57</sup> *Id.* § 4.1(a)(i).

<sup>58</sup> As Harvard Librarian Robert Darnton has put it “... Google will enjoy what can only be called a monopoly—a monopoly of a new kind, not of railroads or steel but of access to information.”

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But antitrust law proper may not forbid this. If we treat Google as having as having obtained its monopoly through a risky, entrepreneurial undertaking and therefore legitimately then, as the Supreme Court said most recently in *Linkline*, Google can charge monopoly prices without facing Section 2 liability.<sup>59</sup> Of course, Google’s “monopoly” status is seemingly being created by the ability of the rightsholders to act collectively. Were they acting separately, there is every reason to think that we would end up with Google and other firms competing to license from individual rightsholders. That would result in more competition and more fragmentation.

And of course, on this framing, Google would also be the *victim* of the exercise of monopoly power and not just a perpetrator. The rightsholders would have combined horizontally to become the sole source of rights and would have chosen to issue only one license. To be sure, Google would have the right to use the copyrighted works and would be the only firm dealing with end users, but Google presumably would have paid dearly for that monopoly franchise in the deal cut with the rightsholders. If we hold an auction for a monopoly franchise, we will clearly suffer from the downstream harms of monopoly but all of the monopoly profits should be competed away in the auction and should inure to the benefit of the auctioneer, here the rightsholders. The actual situation is even more complex because we think that the auction winner will use what it learns in the direct market in adjacent markets. That is, as noted before, many believe that the Non-Display Uses of the book collection will benefit Google in its core search businesses. The rightsholders would love to access a cut of that incremental value and, again, in an auction process for a single rights franchise, we should expect some of the incremental value in adjacent markets to flow to the rightsholders.

The agreement’s second core business model is Consumer Purchases.<sup>60</sup> This seems to contemplate online reading of a particular text with controlled copying, pasting and printing. The pricing mechanism for this access is interesting and seemingly problematic. Books made available this way will be priced either at the price set by the rightsholder or through a mechanism run by Google. The agreement defines a “Settlement Controlled Price.”<sup>61</sup> Books will be slotted into particular pricing bins and indeed the agreement contemplates an initial distribution of prices across bins: 5% of the books will be priced at \$1.99,

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Google will “first, entice subscribers with low initial rates, and then, once they are hooked, ratchet up the rates as high as the traffic will bear.” Darnton *supra* note 3.

<sup>59</sup> See *supra* note 17.

<sup>60</sup> See Settlement Agreement, *supra* note 23, at §§ 1.32, 4.2.

<sup>61</sup> *Id.* § 1.143, 4.2(b)(i)(2).

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10% at \$2.99 and so forth until we reach a final 5% to \$29.99.<sup>62</sup> How does this match up with what we think would emerge under standard competition? I am not sure, as that seems to turn on a sense of exactly how spatial competition works, but I do not think that we can be particularly confident that this centralized spacing approach matches what would emerge from normal, decentralized competition.

Then turn to the pricing mechanism itself. Google is to create a “Pricing Algorithm” that Google is to “design to find the optimal such price for each Book and, accordingly, to maximize revenue for each Rightsholder.”<sup>63</sup> That is not what we expect competitive pricing to do. Competition drives down prices to costs and does not have the effect of maximizing revenues to individual competitors. The rightholders are collectively appointing Google as their agent to implement pricing rules for Consumer Purchases that do not seem to mimic what we would see in pure decentralized competition. In that sense, it works its way towards tracking my digital book cartel hypo in Section II above.<sup>64</sup>

The agreement also recognizes that new revenue models might emerge and contemplates that Google and the Registry will negotiate the terms for any new models that might emerge.<sup>65</sup> Finally, the agreement creates a limited, free public access service. That service has been understandably criticized for being quite narrow<sup>66</sup> with one terminal for every 10,000 students at a college and one terminal in public libraries.<sup>67</sup>

#### D. Who Gets the Money and Unclaimed Funds

Focus next on the money. To track the agreement, start with the big picture and then head into the still-very-important details. Google will pay at least \$45 million in cash into the settlement fund, plus another \$34.5 million to get the Registry up and running, plus attorneys’ fees for the plaintiffs on top of that. On a going forward basis, this is a percentage of revenues deal. Google is to pay the Registry on behalf of the rightholders 70% of the revenues earned by Google

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<sup>62</sup> *Id.* § 4.2(c)(ii).

<sup>63</sup> *Id.* § 4.2(b)(ii).

<sup>64</sup> Two new papers develop this point further. *See* Eric M. Fraser, Antitrust and the Google Books Settlement: The Problem of Simultaneity (June 23, 2009) (unpublished manuscript, on file with author); *see* Christopher Suarez, Proactive FTC/DOJ Intervention in the Google Book Search Settlement: Defending Our Public Values, Protecting Competition (May 25, 2009) (unpublished manuscript, available at <http://ssrn.com/abstract=1409824>).

<sup>65</sup> *See* Settlement Agreement, *supra* note 23, at § 4.7.

<sup>66</sup> Jennifer Howard, *Harvard Says No to Google Deal for Scanning In-Copyright Works*, Chron. Higher Educ., Oct. 20, 2008, available at <http://chronicle.com/news/article/5417/harvard-says-no-thanks-to-google-deal-for-scanning-in-copyright-works>.

<sup>67</sup> *See* Settlement Agreement, *supra* note 23, at §§ 4.8(a)(i)(1), 4.8(a)(i)(3).

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less ten percent for Google's operating costs, resulting in a split of 63% to rightsholders and 37% of revenues to Google.<sup>68</sup>

That is a good starting point but there are some subtleties and they may matter for the overall incentives of the parties. We need to track what the agreement does with regard to revenues associated with public domain works and orphan works. Start with the public domain. The definition of "Book" is one of the key linchpins of the settlement agreement and that definition excludes public domain works.<sup>69</sup> That should have the effect of excluding public domain works from the revenues that would flow to copyright holders. GBS will undoubtedly generate revenues from public domain works and Google will keep all of those revenues. Indeed, the agreement specifically addresses the possibility of mistaken payments by Google with regard to public domain works.<sup>70</sup> All of that certainly matches one vision of how the public domain works: anyone can use it as they wish and make or not make money on it. For fun sometime, go to Amazon and see how many different prices you will find for a work in the public domain.

Turn next to the orphan works. The unclaimed funds provision is particularly important here because of the role that it plays in assigning revenues associated with those works.<sup>71</sup> That provision creates different rules for subscription revenue and non-subscription revenue. Recall that the revenue split in the deal is 70%/30% subject to a 10% discount for Google's operating costs resulting in a net 63%/37% deal. The unclaimed funds provisions make it possible for active rightsholders to get a version of 70% instead of the 63%. Unclaimed funds from non-subscription revenue models are paid first to some of the costs of the Registry and after that to active rightsholders—those who have become Registered Rightsholders—until payments reach 70% of the revenues for their books.<sup>72</sup> That is a 7% carrot and is funded by revenues that arise from orphan works. For revenues that arise from the subscription model, there is a

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<sup>68</sup> *Id.* § 2.1(a). To track the agreement with more detail, Section 4.5(a) defines a standard revenue split for purchases as 70% of Net Purchase Revenues. The definition of that in turn, *id.* 1.87, makes clear that those are all revenues received by Google from all revenue models other than advertising, less the 10% operating cost deduction. There are parallel provisions for advertising revenues, *id.* §§ 4.5(a)(ii), 1.86, though the fact that there are parallel provisions rather than one unified provision suggests that I may be missing some subtle difference between the two.

<sup>69</sup> *See* Settlement Agreement, *supra* note 23, at § 1.16.

<sup>70</sup> *Id.* § 6.3(b).

<sup>71</sup> *Id.* § 6.3(a).

<sup>72</sup> *Id.* § 6.3(a)(i).

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separate Plan of Allocation but, again, unclaimed funds from orphan works will fund additional payments to active rightsholders.<sup>73</sup>

The net effect of the agreement, bolstered by the unclaimed funds provisions, is to turn orphan works into a kind of private public domain. Google will be able to use the orphan works in GBS and both Google and the active rightsholders will benefit from the revenues that arise from those works. This is a common strategy of parties settling intellectual property suits: it is in their joint interest to preserve a property right as against the world. We have seen this pattern before in suits between Lexis and Westlaw regarding the status of page numbers in the West reporting system and in settlements between patent holders and generic entrants in the context of the Hatch-Waxman statute.<sup>74</sup>

## V. MULTIPLYING LICENSES?

We should turn to the question of how many licenses are likely to be granted to use the orphan works. Recall hypo 4 from Section III where the book authors collectivized and then licensed digital rights to Poodle. I asked then: how many licenses are likely to be granted and how does the fact that the authors are collectivizing influence that? How many licenses should we want to be granted?

### A. The Settlement Agreement's Most Favored Nations Clause

To get at this, start with the settlement agreement's most favored nations clause.<sup>75</sup> MFNs are fairly common when deals are done sequentially. An initial contracting party believes that its original agreement will make it possible for its counterparty to enter into other deals with third parties. The original deal may prove the concept and build a blueprint—or at least a starting point—for subsequent deals. An MFN ensures that the beneficiary of it shares in the incremental value that will accrue to its counterparty in other deals and may serve as an important inducement to do the deal in the first place. If potential deal partners believe that there is a second-mover advantage, each partner will hang back and hope that another partner moves first. That logic results in no deals at all—you cannot ever be a second mover if there is a never a first mover. The MFN helps to solve that dynamic problem.

But MFNs can also reduce future competition. A second mover knows that any benefits that it negotiates for will redound to the benefit of the first actor. The second mover knows that it is harder for it to gain a competitive advantage over the first actor and that reduces its incentive to compete to do so in the first

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<sup>73</sup> *Id.* § 6.3(a)(ii), Attach. C, 1.1(e).

<sup>74</sup> See Stephen Labaton, *Westlaw and Lexis Near Truce*, N.Y. Times, July 19, 2008 available at <http://www.nytimes.com/1988/07/19/business/westlaw-and-lexis-near-truce.html>; see *In re Cardizem CD Antitrust Litigation*, 332 F.3d 896 (6<sup>th</sup> Cir. 2003).

<sup>75</sup> See Settlement Agreement, *supra* note 23, at § 3.8(a).

place. And for the party granting the MFN, it knows that any benefit it gives to a later contracting party costs it doubly, not just as a cost in the deal with the second actor but also in the original deal with the beneficiary of the MFN. All of this makes clear why MFNs are tricky and probably hard for us to just embrace wholly or seek to forbid.

The actual MFN set out in the Settlement Agreement is interesting.<sup>76</sup> The MFN protects Google from better deals down the road in the standard fashion that MFNs operate. But what is more interesting is that the MFN seems to suggest that the Registry might be able to grant licenses to other third parties. The trigger for the MFN is a deal better than the one that Google is getting in the settlement agreement sometime in the next ten years and that includes “rights granted from a significant portion of Rightsholders other than Registered Rightsholders.” That is, a deal about orphan works. But who is going to cut that deal for the orphan works? Google’s MFN right is keyed to a deal by the Registry itself or by any substantially similar entity organized by the rightsholders. The MFN certainly operates most naturally in a context where the Registry is understood to have the authority to issue additional licenses for the orphan works. Two other provisions in the settlement agreement might bear on this. The organizational structure provision for the Registry provides that the Registry “will be organized on a basis that allows the Registry, among other things, to ... (iii) to the extent permitted by law, license Rightsholders’ U.S. copyrights to third parties.”<sup>77</sup> And the settlement agreement extends some authority on its own terms for the Registry to act for rightsholders in executing agreements.<sup>78</sup>

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<sup>76</sup> *Id.* § 3.8(a) (“Effect of Other Agreements. The Registry (and any substantially similar entity organized by Rightsholders that is using any data or resources that Google provides, or that is of the type that Google provides, to the Registry relating to this Settlement) will extend economic and other terms to Google that, when taken as a whole, do not disfavor or disadvantage Google as compared to any other substantially similar authorizations granted to third parties by the Registry (or any substantially similar entity organized by Rightsholders that is using any data or resources that Google provides, or that is of the type that Google provides, to the Registry relating to this Settlement) when such authorizations (i) are made within ten (10) years of the Effective Date and (ii) include rights granted from a significant portion of Rightsholders other than Registered Rightsholders. ...”).

<sup>77</sup> *Id.* § 6.2(b).

<sup>78</sup> *Id.* § 6.7 (“Authorization of Registry. Where this Settlement Agreement confers on the Registry rights and obligations with respect to Books and Inserts, including with respect to the Registry’s relationship with each of Google, the Fully Participating Libraries, the Cooperating Libraries and the Public Domain Libraries, Plaintiffs and all Rightsholders, as of the Effective Date, shall be deemed to have authorized the Registry to exercise such rights and perform such obligations on behalf of the Rightsholders with respect to their respective Books and Inserts, including to enter into Library-Registry Agreements.”).

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Those get close to the idea that the MFN contemplates—the Registry granting third parties licenses to use the orphan works—but it is not clear that they get there fully. U.S. copyright law does not generally authorize a third party to act on an author’s behalf, so it is not clear what the agreement picks up. And the registry authorization clause—a power of attorney-type clause—does not empower the Registry to act directly for orphan authors, unless perhaps we conclude that that idea is embedded itself in the MFN in Section 3.8(a).

### **B. Clarifying (?) the Settlement Agreement**

It seems possible that the settlement agreement intends for the Registry to be able to issue new licenses for the orphan works going forward. Again, it is hard to understand where the current version of Section 3.8(a) will work if the Registry cannot grant new orphan-works licenses. If that is indeed the intent of the settlement agreement, we should clarify 3.8(a) and probably make corresponding changes elsewhere in the agreement, perhaps to 6.2(b)(iii), 6.7 and elsewhere. But I also think that there is a pretty good chance that the current version of the agreement does not contemplate a going-forward licensing power for the orphan works.<sup>79</sup> What should the court do about that in considering whether to approve the settlement agreement?

We should start by assessing the incentives of the rightsholders to voluntarily license their digital works and in so doing also license the rights held by orphan holders. If we think that the collection of rights represented in the lawsuit really is unique, then we should not think that the Authors Guild would wish to license them to a second online book search provider. The rights represent a monopoly and licensing use to two or more providers will result in competition between those providers and will almost certainly make the returns to the rights provider much lower. Indeed, in the extreme case—frequently captured in the notion of Bertrand price competition—we might expect multiple online book search service providers to compete price down to marginal cost which may be close to zero.

If that is right, then the lawsuit by the Authors Guild and the proposed settlement agreement are themselves the vehicle to market power. The opt-out

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<sup>79</sup> Google has addressed this question on its public policy blog:

Under the settlement Google will be able to open up access to truly orphaned books, but we still think more needs to be done to allow anyone and everyone to use these works. Any company or organization that wants to open up access to this untapped resource should be able to do so. The settlement is not a panacea, since it only covers a subset of orphaned works, provides only certain uses, and is not able to extend these uses to other providers. The need for comprehensive orphan works legislation is not diminished.

Derek Slater, Google Book Search settlement and access to out of print books, June 2, 2009, <http://googlepublicpolicy.blogspot.com/2009/06/google-book-search-settlement-and.html>.

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class action increases the likelihood that the rightsholders will act collectively in large numbers by shifting the default position on contracting. This is to take the learning of behavioral economics on the importance of defaults and turn it into large-scale contracting to achieve market power. That probably works that way even for identifiable rightsholders but it clearly operates in that way as to orphan authors. Nothing would have prevented large numbers of rightsholders from entering into private contracts with Google to create something akin to GBS but the numbers—and the resulting market power—would clearly have been smaller without the switch in default settings made by the opt-out class action. And what those private contracts could not have accomplished was bringing the orphan works into the deal, but the opt-out class action settlement does just that.

We would seem to have two natural approaches to changing the settlement agreement to ensure the possibility of competing digital books collections: (1) alter the settlement agreement now as part of the approval process to add additional licenses; or (2) ensure that the agreement contains a mechanism for new licenses to be considered going forward. Start with what those licenses might look like substantively. The current MFN gives Google the benefit of any other deals in the next ten years for new licenses of the orphan works. A fully symmetric MFN would make it possible for other entities to get the licensing regime that Google gets for the works licensed by active rightsholders and for the orphan works.

As to the latter, Google can use those fully and the release provisions in the settlement agreement ensure that Google will not face liability for copyright infringement for its use of those works.<sup>80</sup> Google will make payments to the Registry for the revenues that it derives from those works, just as it would any other work in GBS. And the Registry in turn distributes those revenues per the terms of the Settlement Agreement. Remember importantly that active rightsholders effectively benefit from the revenues generated by the orphan works.

A symmetric MFN would allow qualified entities to sign up for the going-forward provisions of the settlement agreement as to both the works of the active rightsholders and the orphan works. That license would mitigate both the problem that the active rightsholders will be reluctant to issue additional licenses on their own for their works—why compete with themselves?—and the problem that the settlement represents the only way to gain access to the orphan works. Note of course that those rights licenses would not actually enable immediate entry into the book search business. Any entrant will have to do its own scanning as nothing I have said here would justify some sort of mandatory access

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<sup>80</sup> *Id.* at Art. X.

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to the scans that Google has created. We should want to foster competition in scanning.

What does “qualified” mean? The rightsholders undoubtedly will emphasize that they cut a deal with Google, not any random entity. The rightsholders are relying on Google’s incentive to go out and make money and pay 63% of the revenues generated to the rightsholders. A non-profit would not have the same incentives to generate revenues. And the rightsholders will argue that they have negotiated for an elaborate protective scheme for the scans that Google has created.<sup>81</sup> The rightsholders will understandably want a Google-class contracting partner if we are going to force them to duplicate the settlement agreement licenses and make those available to others. But those limits should not mean that non-profits are completely left out. The revised MFN should separate out the orphan-works deal from the deal made by the active rightsholders—unbundle the orphan-works license from the overall settlement—and make corresponding licenses (and releases) available to third-parties to use the orphan works.<sup>82</sup>

Active rightsholders might very well object to the Xeroxing of their deal to allow other firms access to licenses to use their works. But that would almost certainly reflect a desire to preserve the incremental market power that accrues to them from the ability to implement their deal with Google through the court system. Proceeding through the court system maximizes their ability to act collectively and it is that which shrinks the number of licenses granted to their works. If the active rightsholders were forced to act outside the court system, we would almost certainly see greater fragmentation in the licenses granted and more competition in book search.

And the active rightsholders would seem to have little basis to object to the expansion of the MFN to encompass additional licenses of the orphan works. I understand that they might want to squelch the competition that might emerge if multiple firms had access to the orphan works. That competition could easily reduce overall industry revenues for digital book search services and that would be against the interest of the active rightsholders given that they are cutting deals tied to percentages of revenues. But eliminating competition cannot be seen as a legitimate goal of the collective action of the active rightsholders captured in the settlement agreement. Absent the lawsuit, the active rightsholders could convey no rights in the orphan works to anyone and we need to guard against their ability to create a monopoly as to those works by issuing only a single license to those works.

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<sup>81</sup> *Id.* at Art. VIII, Attach. D.

<sup>82</sup> One could imagine any number of possible non-profit entrants, including the Internet Archive, the HathiTrust, JSTOR or a completely new nonprofit devoted to these issues.

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The case against expanding the scope of the MFN now or ensuring a mechanism to issue additional licenses going forward might run as follows. Google undertook a substantial risk in digitizing works and putting them online. Even in proceeding carefully by controlling the scope of access to the works, Google faced substantial liability for the core copying of entire works that made this possible. To be sure, Google could make arguments regarding the permissibility of intermediate copying and regarding fair use, but those arguments were far from a sure thing, plus Google was operating at a sufficient scale that were it to lose the damages would likely be substantial.

In granting access to third parties to the rights regime created by the settlement agreement, we face a standard selection problem in that potential competitors are always eager to join in successful projects and share those costs, but rarely volunteer to fund those which have been revealed to be losers. That means that any notion of merely paying some measure of Google's costs in creating the new licensing regime is inadequate in that those costs need to be grossed up for the risk of failure.

If the settlement represents a clever solution to the orphan works problem, we could imagine a number of different approaches to follow-on efforts. One approach would require a subsequent entrant to pursue the same legal strategy. Of course, the path here was entry by Google followed by a class action lawsuit by the Authors Guild. As suggested before, it is not clear that the Authors Guild will want to grant a second collective rights license and that means a second suit might not ever be brought. Of course, the entrant might bring a declaratory judgment action naming as defendants the plaintiff class in the current litigation. But we should ensure that a subsequent entrant does not face an entry barrier based on the inability of a court to obtain new jurisdiction vis-à-vis the orphan works or based on the unwillingness of active rightsholders to grant a second license to the orphan works.

That would suggest a possible more limited approach to the settlement agreement: do not create additional licenses in the settlement agreement now but make sure that some combination of the Registry and the court can do so going forward. As noted before, there is a reading of the settlement agreement that suggests that the Registry can grant new licenses to orphan works under the current agreement. And we could make that more explicit in the agreement. Alternatively—or perhaps in addition—the settlement agreement provides that the district court will retain jurisdiction going forward.<sup>83</sup> If that retained jurisdiction was understood to cover efforts by qualified firms to license works covered by the settlement agreement and to license separately the unbundled orphan works—perhaps thought of as intervening defendants in the original

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<sup>83</sup> *Id.* § 17.23.

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case—that might solve the fear that the Authors Guild might not sue again or that jurisdiction might not attach for a declaratory judgment action.

## VI. ANTITRUST IMMUNITIES AND THE TIMING OF ANTITRUST INQUIRY

To get a handle on the question of timing, consider a counterfactual. Suppose that Google launched its service as it did and that the Authors Guild drafted a complaint identical to the one filed. But in this alternative universe, no lawsuit is filed. Google and the Authors Guild negotiate an arrangement identical to the settlement agreement but they do so without the intervention of litigation. Where would we stand and how does that differ from the current situation?

A number of points matter. The arrangement between Google and the Authors Guild would simply be a matter of contract. Rightsholders who signed on the dotted line would become bound by the contract. Other rightsholders who declined the agreement would of course not be bound. No federal district court judge would have any role in approving the agreement. This would be purely a private matter and there would be no substantive review of the contract at the time of its execution. There would be no contemporaneous evaluation of whether the deal was fair as between the parties or what antitrust consequences might be of the new arrangement. There would of course be no possibility that some sort of *Noerr-Pennington* immunity would attach to the contract. Nor would there be a consideration of whether the contracting rights holders were somehow sufficiently similar that they could sign the same contract.

Now revert to the actual case. A lawsuit was filed: how does that change the analysis? The key point of course is that the nature of an opt-out class action means that the default setting as to whether or not the settlement is agreed to has changed. If a rightsholder does not affirmatively decline the contract, he or she is bound. That is the precise flip of the position we had in the counterfactual, and default positions, as behavioral economics is quick to point out, can matter enormously.

We also will have the fairness hearing on the settlement, but the antitrust analysis in the settlement hearing on the class action is likely to be minimal to non-existent. Circuits differ in the factors that they consider in a fairness hearing, with some looking to many factors, including the public interest, with others—and probably the Second Circuit—focusing more narrowly on what the settlement means for the parties to the lawsuit.<sup>84</sup>

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<sup>84</sup> As the Sixth Circuit framed its test in *UAW v. General Motors Corp.*, 497 F.3d 615, 631 (6<sup>th</sup> Cir. 2007): “Several factors guide the inquiry: (1) the risk of fraud or collusion; (2) the complexity, expense and likely duration of litigation; (3) the amount of discovery engaged in by the parties; (4) the likelihood of success on the merits; (5) the opinions of class counsel and class representatives; (6) the reaction of absent class members; and (7) the public interest.”

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Now we can frame the *Noerr-Pennington* point. In circuits that embrace a party-centered approach to fairness and class-action settlements, no possibility of subsequent *Noerr-Pennington* immunity for the court-approved agreement should attach. The court will not have considered what the competitive consequences would be of the arrangement and therefore clearly have engaged in no shaping or assessing of the agreement in those terms.<sup>85</sup> This case should be treated as our counterfactual case would be where no complaint had been filed. That private contract enjoyed no immunity from antitrust inquiry and in similar fashion these court-approved agreements should not either. And even in circuits that embrace a broader inquiry to fairness hearings, the antitrust analysis is likely to be minimal. This suggests, again, that no *Noerr-Pennington* immunity should attach to the approval of these settlements.<sup>86</sup> If the district court approves the settlement agreement, it should take the additional step of including a no *Noerr* clause in its order approving the settlement. That clause would provide that no antitrust immunities would attach to the settlement agreement from the court's approval of it.

## VII. CONCLUSION

Google boldly launched Google Book Search in pursuing its goal of organizing the world's information. Even though Google was sensitive to copyright values, the service relied on mass copying and thus Google undertook a substantial legal risk in setting up the service. That risk was realized with the lawsuits by the Authors Guild and the Association of American Publishers. The October, 2008 settlement agreement for those suits will create an important new copyright

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<sup>85</sup> This is likely to be true, even if the Antitrust Division of the Department of Justice makes a filing in the case, as it may well do. See Letter from William G. Cavanaugh to Judge Denny Chin (July 2, 2009) (available at Order at 2, *The Authors Guild, Inc., Association of American Publishers, Inc., et al. v. Google Inc.*, No. 05 CV 8136 (S.D.N.Y. July 2, 2009)).

<sup>86</sup> Like most interesting propositions, the caselaw is not clear on whether *Noerr-Pennington* immunity would attach to the court's approval of the settlement agreement. The Supreme Court certainly did not allow a court consent decree to block additional antitrust inquiry into the arrangements in ASCAP and BMI. See *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 13 (1979) ("Of course, a consent judgment, even one entered at the behest of the Antitrust Division, does not immunize the defendant from liability for actions, including those contemplated by the decree, that violate the rights of nonparties."). But more recent lower court decisions have clearly relied on *Noerr-Pennington* to block some challenges to court-approved arrangements. See *Sanders v. Brown*, 504 F.3d 903, 913 n.8 (9<sup>th</sup> Cir. 2007) (finding that *Noerr-Pennington* doctrine protected a private party from antitrust liability from anti-competitive harms resulting from tobacco settlement agreement negotiated with state entity but further declining to resolve whether that doctrine would insulate private parties from an anti-competitive settlement merely because that agreement was approved by a court). The Second Circuit has taken a narrower approach than most circuits to the scope of *Noerr-Pennington* immunity in the master settlement agreements for the tobacco litigation. See *Freedom Holdings, Inc. v. Spitzer*, 357 F.3d 205 (2<sup>nd</sup> Cir. 2004).

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collective and will legitimate broad-scale online access to United States books registered before early January, 2009.

The settlement agreement is exceedingly complex but I have focused on three issues that raise antitrust and competition policy concerns. First, the agreement calls for Google to act as agent for rightsholders in setting the price of online access to consumers. Google is tasked with developing a pricing algorithm that will maximize revenues for each of those works. Direct competition among rightsholders would push prices towards some measure of costs and would not be designed to maximize revenues. As I think that that level of direct coordination of prices is unlikely to mimic what would result in competition, I have real doubts about whether the consumer access pricing provision would survive a challenge under Section 1 of the Sherman Act.

Second, and much more centrally to the settlement agreement, the opt-out class action will make it possible for Google to include orphan works in its book search service. Orphan works are works as to which the rightsholder cannot be identified or found. That means that a firm like Google cannot contract with an orphan holder directly to include his or her work in the service and that would result in large numbers of missing works. The opt-out mechanism—which shifts the default from copyright's usual out to the class action's in—brings these works into the settlement.

But the settlement agreement also creates market power through this mechanism. Absent the lawsuit and the settlement, active rightsholders could contract directly with Google, but it is hard to get large-scale contracting to take place and there is, again, no way to contract with orphan holders. The opt-out class action then is the vehicle for large-scale collective action by active rightsholders. Active rightsholders have little incentive to compete with themselves by granting multiple licenses of their works or of the orphan works. Plus under the terms of the settlement agreement, active rightsholders benefit directly from the revenues attributable to orphan works used in GBS.

We can mitigate the market power that will otherwise arise through the settlement by expanding the number of rights licenses available under the settlement agreement. Qualified firms should have the power to embrace the going-forward provisions of the settlement agreement. We typically find it hard to control prices directly and instead look to foster competition to control prices. Non-profits are unlikely to match up well with the overall terms of the settlement agreement, which is a share-the-revenues deal. But we should take the additional step of unbundling the orphan works deal from the overall settlement agreement and create a separate license to use those works. All of that will undoubtedly add more complexity to what is already a large piece of work, and it may make sense to push out the new licenses to the future. That would mean ensuring now that the court retains jurisdiction to do that and/or giving the new Registry created in the settlement the power to do this sort of licensing.

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Third, there is a risk that approval by the court of the settlement could cause antitrust immunities to attach to the arrangements created by the settlement agreement. As it is highly unlikely that the fairness hearing will undertake a meaningful antitrust analysis of those arrangements, if the district court approves the settlement, the court should include a clause—call this a no *Noerr* clause—in the order approving the settlement providing that no antitrust immunities attach from the court’s approval.